Introductory Section

Comprehensive Annual Financial Report
June 30, 2006

State of Colorado

Bill Owens
Governor

Jeffrey M. Wells
Executive Director

Leslie M. Shenefelt
State Controller

DPA
Department of Personnel & Administration

Office of the State Controller
633 17th Street, Suite 1500
Denver, Colorado 80202
Phone (303) 866-6200
Fax (303) 866-4233
www.colorado.gov/dpa

December 8, 2006

To the Citizens, Governor, and Legislators of the State of Colorado

It is our privilege to present the Comprehensive Annual Financial Report (CAFR) on the operations of the State of Colorado for the fiscal year ended June 30, 2006. This report is prepared by the Office of the State Controller and is submitted as required by Section 24-30-204 of the Colorado Revised Statutes. The State Controller is responsible for managing the finances and financial affairs of the state and is committed to sound financial management and governmental accountability.

We believe the financial statements are fairly presented in all material aspects. They are presented in a manner designed to set forth the financial position, results of operations, and changes in net assets or fund balances of the major funds and nonmajor funds in the aggregate. All required disclosures have been included to assist the members of the General Assembly, the financial community, and the public in understanding the state's financial affairs.

Except as noted below, the basic financial statements contained in the CAFR are prepared in conformity with generally accepted accounting principles (GAAP) applicable to government as prescribed by the Governmental Accounting Standards Board (GASB), and except for the discretely presented component units, they are audited by the State Auditor of Colorado. The basic financial statements comprise the Management Discussion and Analysis (MD&A), financial statements, notes to the financial statements, and Required Supplementary Information. The MD&A, which begins on page 19, contains additional financial analysis and supplementary information that is required by GASB and should be read in conjunction with this transmittal letter. The schedules comparing budgeted to actual activity, included in the section titled Required Supplementary Information, are not presented in accordance with GAAP; rather, they reflect the budgetary basis of accounting which defers certain payroll and Medicaid expenditures to the following fiscal year. In addition to the basic financial statements, the CAFR includes; combining financial statements that present information by fund category, certain narrative information that describes the individual fund categories, supporting schedules, and statistical tables that present financial, economic, and demographic data about the state.

The funds and entities included in the CAFR are those for which the state is financially accountable based on criteria for defining the financial reporting entity as prescribed by GASB. The primary government is the legal entity that comprises the major and nonmajor funds of the state, its departments, agencies, and state institutions of higher education. It also includes certain university activities that are legally separate but have been blended with the accounts of the institution that is financially accountable for the activity.

The state's elected officials are financially accountable for other legally separate entities that qualify as discretely presented component units. The following entities qualify as discretely presented component units of the state:

University of Colorado Hospital Authority
Colorado Water Resources and Power Development Authority
Denver Metropolitan Major League Baseball Stadium District
University of Colorado Foundation
Colorado State University Foundation
Colorado School of Mines Foundation
University of Northern Colorado Foundation
CoverColorado
Venture Capital Authority

Additional information about these component units and other related entities is presented in Note 2 of the financial statements (see page 69). Audited financial reports are available from each of these entities.

PROFILE OF THE STATE OF COLORADO

Colorado became the thirty-eighth state of the United States of America when it was admitted to the union in 1876. Its borders encompass 104,247 square miles of the high plains and the Rocky Mountains with elevations ranging from 3,350 to 14,431 feet above sea level. The state's major economic sectors include agriculture, manufacturing, technology, tourism, energy production, and mining. Considerable economic activity is generated in support of these sectors by government, wholesale and retail trade, transportation, communications, public utilities, finance, insurance, real estate, and other services. Given the state's semi-arid climate, water resource development, allocation, and conservation are ongoing issues for state management.

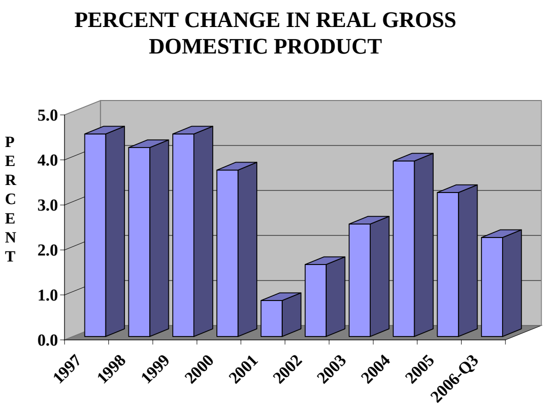
The state maintains a separation of powers utilizing three branches of government – executive, legislative, and judicial. The executive branch comprises four major elected officials – Governor, State Treasurer, Attorney General, and Secretary of State. Most departments of the state report directly to the Governor; however, the Departments of Treasury, Law, and State report to their respective elected officials, and the Department of Education reports to the elected State Board of Education. The elected officials serve four-year terms with the number of terms limited in duration.

The Legislature is bicameral and comprises thirty-five senators and sixty-five representatives who are also term limited. It is a citizen legislature whose general session lasts 120 days beginning in January of each year. Special sessions may be called by the Governor at his discretion and are limited to the topics identified by the Governor. The Legislature's otherwise plenary power is checked by the requirement for the Governor's signature of its legislation and by specific limitations placed in the State Constitution by voters. The most significant fiscal limitation is the restriction related to issuing debt, raising taxes, and changing existing spending limits. From a fiscal perspective, the Joint Budget Committee of the Legislature, because of its preparation of the annual budget and supplemental appropriations bills, holds the most important power vested in the Legislature. The Committee is bipartisan with members drawn from each of the houses of the Legislature. The Governor's Office of State Planning and Budgeting develops and submits an executive branch budget proposal, but there is no requirement for the Joint Budget Committee to adopt that proposal.

The Judicial Branch is responsible for resolving disputes within the state, including those between the executive and legislative branches of government, and for supervising offenders on probation. The branch includes the Supreme Court, Court of Appeals, and district and county courts, served by 262 justices and judges in 22 judicial districts across the state (excluding 17 Denver county court judges). Municipal courts are not part of the state system. There are also seven water courts, one in each of the major river basins. The Judicial Branch budget is appropriated by the Legislature, and it is funded primarily from general-purpose revenues of the General Fund.

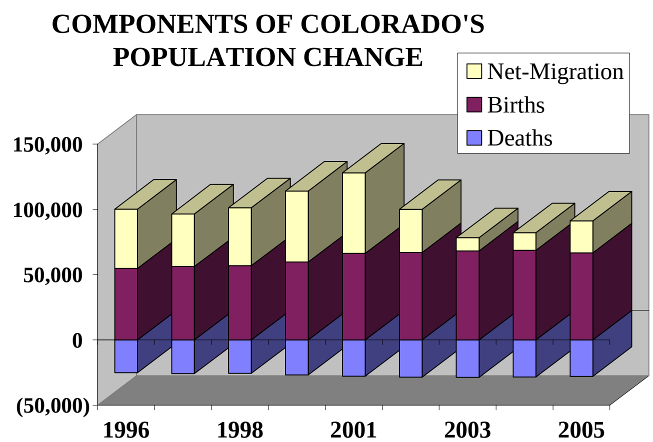
ECONOMIC CONDITION AND OUTLOOK

The state's General Fund revenues reflect the overall condition of the state economy, which showed strong growth in Fiscal Year 2005-06, increasing by $585.0 million (9.5 percent) over the prior year amount. The revenues would have been greater by $220.4 million (total change of 13.1 percent) if not for the diversion of that amount of general-purpose sales tax revenue from the General Fund to the Highway Users Tax Fund. The general-purpose revenue growth is consistent with personal income growth in the state of 6.1 percent and 5.8 percent (forecast) for 2005 and 2006, respectively. It also reflects a significant state employment increase as 49,600 jobs were added in 2005 and 46,600 are forecast to be added in 2006. Colorado's employment increase of 2.2 percent in July 2006 was the sixteenth highest rate of increase in the nation.



Inflation adjusted national gross domestic product (GDP) grew at an annual rate of 3.2 percent in calendar 2005 and at 2.2 percent in the third quarter of 2006. GDP grew 3.0 percent from the third quarter of 2005 to the third quarter of 2006 (all percentage changes in the balance of this paragraph are measured on the third quarter to third quarter basis). National personal consumption expenditures, which account for two-thirds of GDP and were up 2.7 percent, slightly lagged the aggregate growth rate while private domestic investment (including nonresidential structures, equipment and software, residential, and changes in inventories) outpaced the 2.7 percent rate at 6.1 percent. Residential investment declined 7.9 percent (fourth consecutive quarter of decline) offsetting a 14.4 percent increase in nonresidential structures. Government spending also lagged the quarter-over-quarter rate at a 1.7 percent as a decline in national defense expenditures (1.2 percent) offset increases in state and local government spending (2.6 percent) and federal nondefense spending growth (3.0 percent). Quarter-over-quarter export growth (9.0 percent) slightly exceeded import growth (7.2 percent).

Colorado economic activity and in-migration are interdependent, and the economic recovery in Fiscal Years 2004-05 and 2005-06 affected net in-migration in calendar year 2005. In-migration more than doubled from an average of approximately 11,800 in 2003 and 2004 to over 24,400 in 2005. It remains off its peak amount of about 61,600, which occurred in 2001. International in-migration declined slightly from 19,700 to 18,800, for 2004 and 2005 respectively, and the 2004 out-migration to other states of about 5,500 was reversed with a net in-migration from other states of about 5,500 in 2005. The short term economic effect of total in-migration is reduced by the large proportion of international in-migration that likely results in new households that have a lower level of economic activity than households migrating from other states. The information in the adjacent chart is based on current Census Bureau estimates. Data for the year 2000 is not included in the chart because a large adjustment was made to total state population for that year, and matching annual estimates for deaths and births are not available for that year.



The Governor's Office of State Planning and Budgeting (OSPB) predicts that Colorado's economy will continue improving in the near term, and it has made the following forecast for Colorado's major economic variables:

- Employment will grow by 2.6 percent in 2006.

- Unemployment will average 4.6 percent for 2006 compared with 5.1 percent in 2005, and it is expected to fall to 4.5 percent by 2008.
- Wages and salary income will grow by 5.3 percent in 2006 and 5.4 percent in 2007.
- Total personal income will increase by 5.8 percent in 2006 and 5.9 percent in 2007.
- Net in-migration is expected to be 30,000 in 2006 with total population growth of 1.4 percent.
- Retail trade sales will increase 5.5 percent in 2006 and 5.7 percent in 2007.
- Colorado inflation will increase from 2.1 percent in 2005 to 3.5 percent in 2006 and then fall to 3.2 percent in 2007.

MAJOR GOVERNMENT FISCAL INITIATIVES

In the 2006 legislative session, the Legislature passed and the Governor signed significant legislation affecting the fiscal operations of the state. The most immediate impact was the result of various pieces of legislation that implemented the voter's passage of Referendum C in the November 2005 election, which allowed the state to retain revenues in excess of the limits set in the State Constitution.

Referendum C created a General Fund Exempt Account within the General Fund that consists of the retained revenues. Because the amount of retained revenues would not be known until well after the end of the fiscal year, the legislature appropriated a spending plan for the General Fund Exempt Account based on the December 2005 estimate of the amount to be retained. As a result, the state's budget shows $815.2 million appropriated for the activities designated in Referendum C including health care, education, and fire and police pensions.

In addition to the amounts appropriated in the General Fund Exempt Account, the retained revenues made it possible for the legislature to increase General Fund appropriations by approximately $113.0 million. The increase brought the growth in General Fund appropriations to the statutory limit, which activated existing statutory requirements including paying back moneys to the cash funds that were transferred into the General Fund in prior years and diverting sales tax revenues to the Highway Users Tax Fund. The ability to retain excess revenues also resulted in significant General Fund surplus (fund balance on the budgetary basis) that will be transferred to the Capital Projects Fund and the Highway Users Tax Fund in Fiscal Year 2006-07 under pre-existing statutory requirements. These existing statutory requirements when added to the $815.2 million appropriated from the General Fund Exempt Account exceeded the resources available and certain existing General Fund appropriations were reduced.

The Legislature passed legislation to address the unfunded actuarial liability of the Public Employees Retirement Association. The bill provides for additional funding of .5 percent of salary each year beginning in 2008 until an additional 3 percent is being contributed by the state. This additional funding will terminate when each division of PERA reaches 100 percent funding status. The additional funding will come from changes to state employee salaries. The bill also:

- changed benefit provisions for new hires beginning January 1, 2007,
- reduced the prescribed amortization period for the unfunded actuarial liability from 40 to 30 years,
- required the General Assembly to contract for an independent actuarial study before benefits are increased,
- required full actuarial costing of purchases of service credit,
- changed the composition of the PERA board by removing the State Auditor and replacing elected members with gubernatorial appointees with relevant professional experience, and
- allowed new employees of Higher Education Institutions to select the PERA or state defined contribution plan in addition to their existing options.

During the regular 2006 Legislative Session, the Legislature passed laws that among other requirements prohibited state agencies from contracting for services with a contractor who knowingly employs or contracts with illegal aliens and requires state contractors to certify compliance with this law. The Governor called a

Special Session of the Legislature in June 2006 to address additional issues related to illegal immigration. One of the laws passed in the Special Session requires verification of lawful presence in the United States before an applicant qualifies for certain public benefits. The legislature addressed other immigration issues in the regular and special sessions; however, the two items discussed above continue to significantly affected the fiscal operations of state government primarily in the areas of contracting, purchasing, and benefits disbursement.

BUDGETARY AND OTHER CONTROL SYSTEMS

The General Assembly enacts the annual state budget for all ongoing programs, except for federal and custodial funds. New programs are funded for the first time in enabling legislation and are continued through the Long Appropriations Act in future periods. For the most part, appropriations lapse at the end of the fiscal year unless extenuating circumstances prompt the State Controller to approve an appropriation rollforward. Capital construction appropriations are normally effective for three years.

The state records the budget in its accounting system along with estimates of federal awards and custodial funds of the various departments. Revenues and expenses/expenditures are accounted for on the basis used for the fund in which the budget is recorded except for certain budgetary basis exceptions (see Note RSI-1A). Encumbrances are also recorded and result in a reduction of the budgeted spending authority. Encumbrances represent the estimated amount of expenditures that will be incurred when outstanding purchase orders, contracts, or other commitments are fulfilled. Encumbrances in the General Fund are not reported as a reservation of fund balance unless the related appropriations are approved for rollforward to the subsequent fiscal year. Fund balance is reserved for encumbrances that represent legal or contractual obligations in the Capital Projects Fund and the Department of Transportation's portion of the Highway Users Tax Fund.

In developing the state's accounting system, consideration has been given to the adequacy of internal accounting controls. Internal accounting controls are designed to provide reasonable, but not absolute, assurance regarding the safeguarding of assets against loss from unauthorized use or disposition. Those controls also assure the reliability of financial records for preparing financial statements and maintaining the accountability for assets. The concept of reasonable assurance recognizes that the cost of a control should not exceed the benefits likely to be derived from that control. The evaluation of costs and benefits requires estimates and judgments by management. All internal control evaluations occur within this framework. We believe that the state's internal accounting controls adequately safeguard assets and provide reasonable assurance of proper recording of financial transactions.

RISK MANAGEMENT

The state self-insures its agencies, officials, and employees against the risk of loss related to general liability, motor vehicle liability, and workers' compensation. Property claims are not self-insured, as the state has purchased insurance. The state uses the General Fund to account for the risk management function including operations and all matured claims or judgments. (See Note 6-H on page 77, Note 22 on page 103, Note 26 on page 111). Actuarially determined and other long-term risk management claims are reported only on the government-wide *Statement of Net Assets.* Medical claims for officials and employees are managed through the Group Benefits Plan Fund, a Pension and Employee Benefits Trust Fund that also became self-insured during Fiscal Year 2005-06. The Regents of the University of Colorado, the Board of Governors of the Colorado State University System, and the Board of Trustees of University of Northern Colorado individually manage the risks to which they are exposed and do not participate in the state's risk management fund.

INDEPENDENT AUDIT

The State Auditor performs an audit of the Basic Financial Statements. The opinion of the auditor is on page 16 of this report. Besides auditing the statewide financial statements, the auditor will from time to time audit the financial statements and operations of various departments and institutions within state government.

In 1996, the United States Congress amended the Single Audit Act of 1984. The amended act clarifies the state's and the auditor's responsibility for ensuring that federal moneys are used and accounted for properly. Under the requirements of this act, transactions of major federal programs are tested. The state prepares a Schedule of Expenditures of Federal Awards for inclusion in the State Auditor's Statewide Single Audit Report. The State Auditor issues reports on the schedule, the financial statements, internal controls, and compliance with the requirements of federal assistance programs.

CASH MANAGEMENT

Statutes direct the State Treasurer to invest cash that is not immediately needed to pay obligations of the state. These investments may consist of obligations of the United States, commercial paper of prime quality, repurchase agreements, bank acceptance agreements, and other investment instruments. The State Treasurer also invests funds of the Colorado Water Resources and Power Development Authority, a component unit, and the Great Outdoors Colorado Trust Fund, a related organization. Both are accounted for in the treasurer's agency funds. At June 30, 2006, the State Treasurer held the following investments at fair value:

Investment Type	Amount in Millions
U.S. Government Securities	$ 1,927.3
Commercial Paper	1,403.5
Asset Backed Securities	722.4
Corporate Bonds	492.3
Mutual Funds	103.0
Mortgages Securities	79.7
Total	$ 4,728.2

CERTIFICATE OF ACHIEVEMENT

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the State of Colorado for its comprehensive annual financial report for the fiscal year ended June 30, 2005. This was the ninth consecutive year that the government has achieved this prestigious award. In order to be awarded a Certificate of Achievement, a government must publish an easily readable and efficiently organized comprehensive annual financial report. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe that our current comprehensive annual financial report continues to meet the Certificate of Achievement Program's requirements, and we are submitting it to the GFOA to determine its eligibility for another certificate.

ACKNOWLEDGMENTS

In conclusion, I thank my staff and the accountants and program managers in all of the state departments and branches whose time and dedication have made this report possible. I reaffirm our commitment to maintain the highest standards of accountability in financial reporting.

Sincerely,

Leslie M. Shenefelt

Leslie M. Shenefelt
State Controller

Certificate of Achievement for Excellence in Financial Reporting

Presented to

State of Colorado

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 2005

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.

GOVERNMENT FINANCE OFFICERS ASSOCIATION OF THE UNITED STATES AND CANADA CORPORATION SEAL CHICAGO

President

Executive Director

PRINCIPAL ORGANIZATIONS AND KEY OFFICIALS